The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Interest Rates 2

Just when you thought it was safe to anticipate lower interest rates, a combination of rapid money supply growth, strong demand for funds from both the private and the public sectors and a rebound in inflation expectations has induced a sharp upward reversal of both short- and long-term interest rates. What is more, this spiral does not yet seem to have run its course with rates seemingly headed even higher. What went wrong?

First, effective control of money supply growth continues to elude the Federal Reserve. During the past 13 weeks, for example, M-1A has advanced at a seasonally-adjusted annual rate of 12.8 per cent while M-1B has expanded at a 15.5 per cent annual rate. Although the year-to-date expansion of both M-1A and M-1B is at or near their respective maximum growth target boundaries, a marked deceleration in the rate of monetary growth is now required if these targets are to be met.

Second, business loan demand remains strong despite the rise in business lending rates. Commercial and industrial loans at large weekly reporting banks expanded at a 20 per cent seasonally-adjusted annual rate during the past three months. Not only has the growth of business loans been rapid in recent months compared with second-quarter loan activity (when C & I loans outstanding declined), but it is also strong in relation to year-earlier growth rates. During the comparable 13 week period in 1979—a year of massive short-term debt acquisition by U.S. business—commercial and industrial loans expanded at a 16 per cent annual rate, slightly lower than recent experience.

Additionally, economic activity continues to rebound. Among the more recent indicators confirming the slight strengthening of economic activity: "Real" GNP rose in the third quarter at a one per cent annual rate, industrial production has begun to revive and new housing starts continued to expand. But unfortunately, inflation expectations remain at unacceptably high levels—fueled in large part by Washington's continuous inability to balance its books. This week the U.S. posted its 11th consecutive budget deficit—and the second largest ever. Prospects for the current fiscal year look equally as bleak.

Put simply, these developments are all signs of expansion rather than recession and, if unchecked, may well result in an even tighter monetary policy stance. If so, interest rates will move still higher before declining later this year and in early 1981. By that time, the rapid ascent of interest rates, in general, and mortgage rates, in particular, will have become self-limiting, dampening whatever recovery might be underway in retail sales, automobiles and housing. This, in turn, should ensure a decelerating rate of inflation and slower money supply growth—thus a return to declining interest rates.

More Bad News On Productivity . . .

Although private sector productivity improved in the third quarter for the first time since the fourth quarter of 1978, there is little reason to rejoice. The 1.4 per cent increase, rather than indicating a change in the underlying factors which determine productivity levels, is the result of a lag between rising output and rising employment. As economic activity increases, business is slow to add new workers until confident of sustained demand. Output per man-hour consequently rises. The reverse occurs during economic downturns when payroll cuts lag output reduction.

When the current rise in productivity is compared with previous cycles, there is less cause for optimism. During the second quarter of 1975, after the end of the 1973-75 recession, productivity soared by almost 12 per cent for the total private sector and 21 per cent in manufacturing. In the third quarter of 1980, manufacturing registered a productivity decline of 2.7 per cent at an annual rate, as output declined by 10.7 per cent and the number of hours worked dropped 8.3 per cent. This was the fourth consecutive quarter of declining productivity in the manufacturing sector, the longest period of decline since 1955-56.

. . . Profits . . .

Corporate profits fell again in the third quarter as industrial production remained slow, underutilization of capacity continued and "real" final sales remained

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sluggish. Heavily influenced by record losses in the automotive industry, it would appear that there was a ten per cent decline in pretax corporate profits in the third quarter. Although some oil companies still reported hefty profits, those with large refining and marketing operations did not. Sharply reduced demand for oil due to recession and conservation efforts by both consumers and industry resulted in an oil glut, which in turn forced refiners to reduce prices and cut production schedules, thus significantly narrowing profit margins.

The automotive sector and associated industries are currently the recession's biggest losers. During the first three quarters of 1980 the auto industry posted the worst financial results in its history. As a result of persistently low sales, the top three automakers suffered record losses totaling $1.5 billion in the second quarter of 1980 and $1.7 billion during the third quarter. Domestic car sales probably bottomed during the April-June period, as the industry averaged sales of 5.5 million units at annual rates. Sales have since rebounded to a 7.2 million unit clip. However, continued recovery is expected to be slow. Climbing interest rates and the erosion of consumer buying power due to inflation may prevent a significant rebound in automobile purchases for some time.

The copper industry has been adversely affected by slumping auto sales and also by the depressed

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/22/80	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	131.092	+ .112	+ 8.630
Member Bank Borrowings	1.203	+ .096	+ 1.757
Float	5.177	+ 1.836	− .158
Total Reserve Bank Credit	143.291	+ 2.103	+ 7.960
Treasury Deposits with Federal Reserve Banks	3.201	− .105	− .304
Currency Outside Banks	120.024	+ 1.075	+10.160
Member Bank Reserves:			
Required	42.111	+ 1.152	+ .559
Excess (Deficiency)	.114	− .099	− .050
Total Reserves Held	42.225	+ 1.053	+ .509
Net Borrowed Reserves	1.020	− .187	− 1.608
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	85.599	− .764	+ 2.570

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M-1A	387.2	+ 16.1	+ 5.7
M-1B	411.2	+ 18.5	+ 7.4
M-2 (September '80)	1,640.4	+ 14.5	+ 9.1
L (July '80)	2,245.0	+ 8.3	+ 8.8

†Seasonally adjusted. * Seasonally adjusted annual rate.

New York Money Market

Offering Rates 10/31/80	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.50%	12.59%	12.17%
* Federal Agencies	13.75	13.75	13.70
* Project Notes—Taxfree (46% Taxable Equivalent)	9.26	11.57	11.30
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	14.20	14.35	

‡Finance Company Paper—Prime

5- 14 days	13.25%
15- 29 days	13.30
30- 59 days	13.13
60-179 days	12.00
180-270 days	11.75

‡* Bankers' Acceptances

Nov.	13.50%
Dec.	13.50
Jan.	13.40
Feb.	13.40
Mar.	13.30
Apr.	13.30

‡Industrial Paper—Prime

30- 89 days	13.25%
90-120 days	13.50

†Federal Funds Effective Rate 13.80%

‡Discount Basis. * Subject to Availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'80	$ 2,583	$ 2,521	$ 2,397
Gross National Product (1972 Dollars)*	3rd Q'80	$ 1,412	$ 1,409	$ 1,433
Percent Change, Annual Rate	3rd Q'80	1.0%	− 9.6%	9.6%
Change in Consumer Prices (all urban consumers)*	Sept '80	12.0%	8.4%	14.4%
Change in Producer Prices*	Sept '80	− 2.4%	18.0%	18.0%
Civilian Employment (Thousands of Persons)†	Sept '80	97,207	97,006	97,504
Unemployment as % of Civilian Labor Force†	Sept '80	7.5%	7.6%	5.8%
Personal Income*	Sept '80	$ 2,160	$2,140	$1,960
Leading Indicators Composite Index (1967=100)†	Sept '80n	133.6	130.5	140.1
Industrial Production Index (1967=100)†	Sept '80	142.4	141.0	152.7
Net Change in Consumer Installment Credit†	Aug '80	$ 0.02	−$ 0.61	$ 2.45
U.S. Merchandise Trade Balance†	Aug '80	−$ 0.13	−$ 0.92	−$ 2.56
Plant and Equipment Expenditures*	4th Q'80	$193.17(a)	$195.54(a)	$186.95
Private Housing Starts (Thousands of Units)*	Sept '80	1,544	1,416	1,874
New Construction Expenditures*	Aug '80	$ 212.9	$ 214.2	$ 231.6
Total Business Inventories†	Aug '80	$ 451.5	$ 449.5	$ 417.3
Total Business Sales†	Aug '80	$ 308.1	$ 303.9	$ 293.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

conditions in the housing industry. These two areas account for two thirds of all copper produced. Copper consumption has declined by 63 per cent since the first of the year, and the industry's situation was further aggravated by a strike against manufacturers which started on July 1. As a result, most companies reported substantial losses this quarter.

The steel industry, also heavily dependent on the automobile industry, suffered even more. Total domestic shipments dropped to a nine-year low during the quarter, plants ran at around 50 per cent of capacity and the number of workers employed in the industry was the lowest since the Great Depression. In an effort to stimulate sales, steel producers offered discounts which caused even more red ink to flow.

Earlier declines in the housing sector were also felt by related industries such as forest products. As the outlook for housing improved following the second quarter decline in interest rates, lumber and plywood prices rose rapidly. However, this rebound was cut short by the resurgence in mortgage interest rates beginning in late June, which threatens to choke off the housing recovery. Lumber and plywood prices thus topped out at much lower levels than their most recent peak registered in early fall of 1979, before falling again at the end of the third quarter.

(Continued on back page)

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (10/15/80)	95,817	– 1,542	+ 5,888
New York City (10/15/80)	22,431	– 686	+ 3,822
Commercial Paper (10/15/80)	124,377	+ 643	+15,531

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/15/80)	165,909	+ 359	+12,739
New York City (10/15/80)	48,900	+ 84	+ 3,953

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/15/80)	410,737	+ 1,659	+19,007
New York City (10/15/80)	95,308	+ 1,561	+ 6,141

Financial Markets

	Friday 10/31/80	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	13.26%	+ 1.51	+ .64
180-Day Bills†	13.83	+ 2.08	+ .79
Longest Bills†	13.66	+ 2.20	+ .76
Recent Issues:			
12⅛s 10/31/82 (When Issued)	13.10	NA	
12½s 9/30/84	12.87	+ .83	
10¾s 8/15/90	12.41	+ .68	
10⅜s 11/15/09	12.21	+ .60	
Municipals:			
Bond Buyer–20 Bond Index* (10/30/80)	9.45%	+ .39	+ 2.19
Blue List Total ($ Million	$ 874	– $ 65	+ $ 365
30-Day Visible Supply ($ Million)	$1,989	+ $279	+ $ 229
Total	$2,863	+ $214	+ $ 594
Corporates:			
Moody's Aa Composite (10/30/80)	13.41%	+ .74	+ 2.35
Money Mgr.–30-Day Supply ($ Million)	$3,623	– $ 57	+ $1,864
Stocks:			
Dow-Jones Averages:			
Industrials	924.49	– 19.11	+ 105.55
Transportation	361.31	– 12.16	+ 128.50
Utilities	110.99	– 1.75	+ 10.45
65 Stocks	352.08	– 8.49	+ 67.11
Standard and Poor's 500 Stocks	127.47	– 2.38	+ 24.87
N.Y.S.E. Composite Index	73.53	– 1.37	+ 15.36
N.Y.S.E. Avg. Daily Vol. for Week (000's)	38,250	– 6,872	+ 12,420

* 46% Taxable Equivalent 17.50%.

† Bond Equivalent

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/31/80	Week Ago
Overnight	13.50%	13.13%
1 month	14.50	13.50
3 month	15.06	13.94
6 month	14.94	13.88
1 year	14.13	13.25
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	12.95%	12.20%
Long Term (7 to 15 yrs.)	13.05	12.35

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/31/80)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.03267	30.61
Canada	.8485	1.1785
Denmark **	.1698	5.8690
France	.2272	4.4010
Germany	.5240	1.9085
Italy	.001107	903.00
Japan	.004713	212.20
Mexico	.04325	23.12
Netherlands	.4844	2.0645
Switzerland	.5814	1.7200
U.K.	2.4380	.4102

. . . And Inflation

Finally, the last inflation report released before the election adds to the disappointing news. The Consumer Price Index (CPI) returned to double-digit rates of rise in September as it advanced by 12.7 per cent at an annual rate after a brief respite in July and August. As expected, food prices at grocery stores led the increases with 1.9 per cent. Meats, poultry, fish and eggs were the major culprits, rising 3.5 per cent last month, or more than 51 per cent at an annual rate. This reflected not only the drought's damage to livestock feed crops but also previously planned production cutbacks for hogs and poultry by farmers in an attempt to boost prices from unsustainably low levels of last spring and early summer.

The mortgage interest rate component of the CPI did not reflect the run-up of mortgage interest rates which has been underway since June since it dropped by 1.6 per cent. However, sharply higher home prices, the reacceleration in the cost of home-related services such as property insurance, household maintenance and repairs and the rise in household furnishings—the largest since March—more than offset the decline in mortgage costs and made home ownership 0.6 per cent more expensive last month. Meanwhile, energy commodities' prices slipped by 0.3 per cent as home fuel oil prices dropped by 0.1 per cent, and gasoline prices retreated for the fifth consecutive month. H

Manufacturers Hanover Geobankers in Guangzhou for 48th CECF

Customers and friends are welcome to consult Mantrust officers in Suite 566 Dong Fang Hotel during the 48th Chinese Export Commodities Fair October 15 through November 15, 1980.

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